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Resources mobilization and enabling environment for poverty eradication in the context of the implementation of the Programme of Action for the Least Developed Countries for the Decade 2001-2010

World Economic and Social Survey, 2004**

Chapter I
The world economy in 2004***

Summary

Prospects for growth of the world economy, after a sub-par performance for about three consecutive years, have improved conspicuously in 2004. The strength of the world economy remains, however, largely cyclical in nature, and the accelerating phase of the expansion in most economies is expected to end gradually in the second half of 2004. The key challenge for policy makers worldwide is therefore how to transform the strong cyclical upturn into sustained robust long-run growth.

The improvement in the economic outlook has been almost universal across countries but differences in economic vigour among regions and countries remain. The economy of the United States of America is expanding apace, with the latest indication of a long-awaited revival in employment providing one more vital support for continued growth. The recovery in Japan has been stronger and more tenacious than expected by most analysts, increasing the probability that the economy will be able to extricate itself from its decade-long stagnation and deflation. Developing economies in Asia have been further strengthening their performance, with the dynamism of their international trade generating growing synergies for the region

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and enhancing its role as a locomotive for global growth. However, emerging signs of overheating in some sectors and areas in China — the primary driver of growth for the region — have raised concerns. A noticeable increase both in the demand for and in the prices of commodities has contributed to growth in more and more economies in Latin America and Africa, but continued improvements in economic policy remain crucial if these regions are to attain the higher, sustainable rates of growth necessary to achieve meaningful development progress. Meanwhile, most economies in transition, which fared relatively well in the past global downturn, seem likely to increase growth further in the global upturn. By contrast, economic activity in most Western European economies has been largely anaemic, although there are signs of a gradual improvement. In Western Asia, economic prospects for many economies are still vulnerable to political instability and geopolitical tensions with such factors also remaining the main sources of uncertainty for the global economy as a whole.

In the past two years, macroeconomic policies have been crucial for stimulating the global recovery, but the present challenge is for policies to simultaneously sustain robust growth and maintain stable inflation. Notwithstanding solid global growth, aggregate world output remains below potential, as indicated by widespread weak employment growth: unemployment rates remain higher than the lows of the past few years in the majority of countries, while high unemployment and underemployment persist in many developing countries. Nevertheless, there have been growing concerns about emerging signs of overheating in some countries and sectors, as implied by the surge in the prices of many commodities, the rapid credit expansion in some countries and rising inflation rates in many economies. Under such circumstances, macroeconomic policies in many economies have to strike a balance between accommodating, to the maximum extent, strong growth and at the same time managing the potential risks for an escalation of inflation.

Macroeconomic policies alone may not be sufficient to resolve all the problems giving rise to unemployment and inflation. Policies to reduce the prevailing macroeconomic imbalances are equally important for sustaining strong growth beyond the cyclical recovery. The implementation of such reforms is opportune when economic growth is accelerating, as at present; the positive economic outlook should not allow the urgency of reform to be overlooked.

Along with the global recovery, there have been changes occurring in the global geo-economic pattern with China and, to a lesser degree, India and a few other large emerging economies becoming more important as driving forces for world economic growth. The emergence as engines of global growth of the two most populous developing economies, together accounting for the majority of the world's poor, has potentially profound implications for the rest of the world: it has reduced, and will continue to reduce, poverty in the world and narrow international income gaps; it can also generate impetus for the growth of many other developing countries; and it may also require substantial structural adjustments on the part of other economies, some of which may be costly.

Although the world economic situation is improving, there are important downside risks. The increased price of oil, if it persists or rises further, is likely to slow the world economy and have particularly adverse effects on poorer oil-importing developing countries. Secondly, the prevailing large international imbalances, reflected primarily in the widening current-account and fiscal deficits of the United States, are not expected to narrow soon. To ensure more balanced global

growth and, more importantly, to ensure the robust growth necessary to achieve the Millennium Development Goals in the majority of developing countries, policy makers worldwide should expedite the implementation of their international development commitments of recent years.

Sustaining robust growth

As projected,[1] the momentum gathered by the world economic recovery in the second half of 2003 has strengthened further in 2004 and has broadened to include a growing number of economies and sectors. Gross world product (GWP) is forecast to grow by 3.7 per cent in 2004, moderating to 3.4 per cent in 2005 (see table I.1).

Table I.1
Growth of world output and trade, 1995-2005
(Annual percentage change)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003[a]*	*2004[b]*	*2005[b]*
World output[c]	2.8	4.0	3.7	2.4	3.2	4.0	1.3	1.8	2.7	3.75	3.5
of which											
Developed economies	2.4	2.9	3.3	2.6	3.1	3.5	1.0	1.3	2.1	3.25	2.75
North America	2.5	3.6	4.5	4.2	4.6	3.8	0.6	2.3	3.0	4.5	3.5
Western Europe	2.4	1.7	2.5	2.8	2.9	3.5	1.6	1.1	0.8	2	2.25
Asia and Oceania[d]	2.1	3.4	2.1	-0.6	0.4	2.7	0.6	0.0	2.5	3	2
Economies in Transition	-0.2	0.2	2.5	-0.5	3.6	6.5	4.4	4.0	5.7	5.75	5.5
Central and Eastern Europe	6.1	4.4	3.4	2.9	2.1	3.9	2.7	2.7	3.6	4	4.25
Baltic States	2.9	4.2	8.1	5.8	0.0	5.6	6.9	6.3	7.5	6.5	7
Commonwealth of Independent States	-5.2	-3.7	1.4	-4.0	5.4	9.3	5.9	5.1	7.6	7.25	6.5
Developing economies	4.7	5.8	5.4	2.0	3.6	5.8	2.3	3.4	4.4	5.25	5.25
Africa	3.1	5.3	3.4	3.0	3.0	3.3	3.1	2.9	3.3	4	4.75
Eastern and Southern Asia	8.2	7.4	6.2	1.3	6.3	7.2	4.0	5.7	6.1	7	6.25
Western Asia	4.1	4.9	3.9	2.6	-0.2	5.6	-0.5	3.1	4.6	2.75	3
Latin America and the Caribbean	0.5	3.9	5.3	2.4	1.1	4.4	0.4	-0.3	1.5	3.75	4.25
World trade	8.6	5.5	9.2	3.3	5.2	11.5	-0.9	2.5	5.8	7.25	7.5
Memorandum item											
World output growth with PPP-based weights[e]	3.5	4.0	4.2	2.6	3.6	4.7	2.3	2.9	3.7	4.5	4.25

Source: Department of Economic and Social Affairs of the United Nations Secretariat (UN/DESA).

[a] Partly estimated.

[b] Forecasts, based in part on Project LINK, an international collaborative research group for econometric modelling, coordinated jointly by the Economic Monitoring and Assessment Unit of the United Nations Secretariat, and the University of Toronto.

[c] Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.

[d] Japan, Australia and New Zealand.

[e] Employing an alternative scheme for weighting national growth rates of GDP, based on purchasing power parity (PPP) conversions of national currency GDP into international dollars (see introduction to annex: statistical tables).

For many economies, the recovery was initially driven by policy stimuli and/or external demand, but has gradually developed broad strength based on domestic demand.[2] Business profits and business investment have been recovering strongly, particularly in some major developed economies, but also in a number of developing countries. Meanwhile, rates of capacity utilization have also been rising steadily in a growing number of countries. Most equity prices, while below their previous "irrationally exuberant" peaks, have recuperated to a large degree. In contrast, the recovery of employment has been slow worldwide.

The international economic environment has also become more favourable. World trade grew by about 6 per cent in 2003, more than twice as fast as in the previous year, and prices for most commodities also rose, in some cases substantially. There were no major new trade restrictions, although progress in the Doha negotiations was negligible. The cost of borrowing on international capital markets fell and financial flows to developing countries and economies in transition increased, most notably because of a resurgence in bank lending (to its highest level since the Asian financial crisis in 1997). Official development assistance (ODA) rose to the highest level ever recorded, but total net official flows declined, mostly because of repayments of International Monetary Fund (IMF) loans.

The *United States of America* continues to lead global economic growth. After an exceptionally strong rebound in the second half of 2003, growth remains robust in 2004. Business investment in equipment and software is accelerating, supported by a solid improvement in corporate profits and historically low interest rates. Consumer spending continues to grow robustly. More importantly, exports, which were sluggish for the past few years, have revived. On the supply side, labour productivity has risen at an exceptionally strong rate and continues to improve. The recovery of employment has been slow, as gains in productivity from technological innovations and other structural changes may have delayed hiring. However, there was an improvement in the second quarter of 2004 and the employment situation is expected to improve over the course of 2004. The deteriorating fiscal position, the widening external deficit and the weakening of the dollar vis-à-vis other major currencies are among the major concerns.

Economic activity in *Western Europe*, with the exception of the *United Kingdom of Great Britain and Northern Ireland*, has been sluggish to date but a continuation of the gradual recovery is expected. The weak growth so far has been primarily supported by net exports, along with an increase in inventories and some recovery in fixed investment; consumer spending has been dragging. Industrial production rose significantly in late 2003, although it weakened slightly at the beginning of 2004, with most of the strength being in the intermediate, energy and capital goods sectors. The service sector was much weaker. Survey results indicate that, after a sharp improvement in industrial confidence over the past several months, there have been some signs of relapse lately, reflecting wavering views about future business conditions. The gradual rebound will continue to rely on an expansion of exports and investment spending. Consumption is expected to pick up, but not to such an extent as to play a major role in generating growth. The slow improvement in labour-market conditions, coupled with the uncertainties stemming from the outlook for reforms regarding pensions, health care and the labour market, could cause consumers to raise savings rates, dampening consumption. Despite the appreciation of the euro, which negatively affects European exports to those countries whose exchange rates have moved with the United States dollar, the

strength of world activity is expected to be sufficient to generate a significant acceleration in exports.

Japan is expected to grow by about 3 per cent in 2004. The resurgence has been driven mainly by exports, particularly from other Asian economies. The external demand-led recovery has gradually been feeding through to the domestic sector, with an increasing number of companies showing positive domestic earnings. Business capital spending is growing at a brisk pace as corporate profits grow strongly, and the latest surveys show that the improvement in corporate investment conditions is broadly based. For economic growth to become more self-sustained, the strength of the business sector needs to be transferred to the household sector through increases in wages and employment. Meanwhile, elimination of deflation requires action to be taken with regard to a number of structural problems, such as the decreasing but still large volume of non-performing loans, the fragile financial positions of both the public and the private sectors, and the need for corporate restructuring.

In respect of other developed economies, the substantial appreciation of their currencies vis-à-vis the United States dollar has had an adverse impact on Australia, Canada, and New Zealand, making monetary conditions in these economies more restrictive than indicated by their domestic interest rates. After a slowdown in 2003, gross domestic product (GDP) growth in Canada is expected to recover in 2004, supported by low interest rates and a recovery in exports. In Australia, consumption, residential construction and business investment are all growing robustly. Meanwhile, net exports have also started to show some improvement. Some moderation in GDP growth is expected in late 2004, as the rise in household debt, housing prices and the external deficit all seem to be unsustainable. In New Zealand, after growth averaging 3.7 per cent annually for the past five years, the strength of the economy is expected to moderate in 2004-2005, especially if housing prices reverse and net immigration slows.

GDP growth in *Africa* is expected to accelerate in 2004-2005 as many countries achieve an increase in agricultural and industrial output. Higher consumer spending, increasing investment, including more foreign direct investment (FDI) in several countries, and expanded, though cautious, government expenditure in a growing number of countries are expected to support rising domestic demand. Meanwhile, a more auspicious external environment, including higher prices of commodities and increased demand for Africa's exports, should improve the prospects of a large number of countries in the region. However, the current boom from oil and non-oil commodity exports, as well as exports of manufactured goods to the European Union (EU) and the United States under improved market access agreements, will begin to taper off in 2005. The short-term outlook for Africa is favourable in the absence of any major supply-side shocks to domestic output such as adverse weather conditions that would disrupt agricultural output or, for fuel-importing countries, a prolongation of the surge in the price of oil.

Economic growth is accelerating in *East Asia*, fuelled by the region's traditional source of dynamism — international trade. A recovery in the second half of 2003 was initiated by strengthening demand from the United States and an upturn in global information and communication technologies (ICT) product markets. While the impetus from powerful growth in China continues to increase, a better-than-anticipated recovery in Japan has added new strength to the region's growth,

engendering a rapid expansion of intraregional trade. Meanwhile, supported by expansionary policies, rebounding equity prices and increased confidence, private consumption and business investment have strengthened further, with a broad-based recovery in both the service and manufacturing sectors. Moreover, imports in a growing number of Asian economies have recently begun to outpace exports, suggesting an increasing contribution to the recovery in the rest of the world. At the same time, the improvement in labour markets has been relatively weak. Inflation remains subdued in the region, and the small number of economies that experienced deflation in the past have either reversed it or improved the situation. The surge in the prices of commodities and the policy interventions in foreign exchange markets seem to have increased inflationary pressure in some economies, presaging a gradual removal of policy stimuli.

After a rebound in 2003, growth in *South Asia* is expected to solidify further in 2004, with more balance across countries and sectors. The external sector of the region has been strong: while the extraordinary surge in Pakistan's exports in 2003 has moderated as the one-off effects of increased textile quotas wane, India's exports and imports are both increasing sharply, with exports being driven by ICT-related products and services. The appreciation of local currencies in the region against the United States dollar does not seem to have led to any significant dampening effects on the region's exports so far, but it has joined with the rebound in domestic demand to raise the demand for imports. That international tourism to the region has also been improving is especially important for the economies of Nepal and Sri Lanka. Meanwhile, a recovery in the agricultural sector (with the exception of Sri Lanka) has contributed to higher incomes in the region.

The economic prospects for *Western Asia* are still heavily conditioned by geopolitical developments in the region, particularly the situation in Iraq and relations between Israel and Palestine. Since mid-2003, the economic improvement in Iraq has been dilatory, with oil production and exports increasing gradually; however, insecurity and a plethora of other difficulties and uncertainties remain and the attainment of economic and political normalcy in the country is likely to require both a longer time and more resources than anticipated. Meanwhile, the conflict between Israel and Palestine has escalated. The only propitious sign for the region, specifically for the oil-exporting economies, is the higher dollar price of petroleum, a benefit itself discounted by the depreciation of the United States dollar. GDP growth for the region as a whole in 2004 is expected to decelerate to 2.8 per cent, accelerating slightly in 2005.

The short-term economic outlook for *Latin America and the Caribbean* continues to improve. After a recession in 2001-2002, the momentum of recovery in the second half of 2003 has carried over into 2004. The global cyclical upturn has led to more favourable external conditions for the region. Stronger demand from North America, Japan and China and the substantial rise in the prices of commodities have boosted the growth of exports from the region. At the same time, the depreciation of the United States dollar, along with more flexible exchange-rate regimes, has allowed most countries to ease monetary policy: interest rates in many economies are now at multi-year lows. Meanwhile, investor confidence continues to improve, as reflected by the rebound in asset prices and the narrowing of sovereign debt spreads. For the first time in decades, the region has registered a current-account surplus. All these improvements suggest continued, but relatively modest, growth in 2004-2005. The region, however, faces downside risks, including

susceptibility to the vicissitudes of commodity prices and to a tightening of monetary policy in the United States, potential difficulties in servicing its external debt and political tensions in some countries.

After acceleration in 2003, the outlook for the economies of the *Commonwealth of Independent States (CIS)* remains robust for 2004-2005. The economic vigour of the region is bolstered by a confluence of improved domestic fundamentals; higher production, exports and prices of petroleum and gas; and increased foreign investment. Improved consumer and investor confidence, due largely to increased political stability and progress in policy reforms, also continues to support growth. Household consumption has been recovering strongly, boosted by increases in real wages and pensions. Investment has also accelerated, although it is still concentrated in the energy sector. The Russian Federation continues to be the engine of growth for the region, supported by the rapid expansion of other large economies. If the prices of petroleum weaken, however, growth may moderate in 2004 from the rate of over 7 per cent in 2003. The diversification of economic growth away from the present heavy reliance on oil and gas will require steady progress in other sectors. Striking a balance between macroeconomic stability and implementing reforms to achieve longer-term growth remains the major challenge.

The economic prospects for *Central and Eastern Europe* continue to improve. Growth in the region accelerated in 2003, mostly owing to the improved performance of the Polish economy, with the momentum of growth shifting to the countries of South-eastern Europe. Further acceleration is expected in 2004 as external demand increases. Stronger growth in South-eastern Europe is expected to be supported by high rates of investment associated with ongoing privatization and the upgrading of production facilities; and a recovery in investment is also expected in Central Europe, especially in Poland, where financial conditions in the corporate sector are improving. Monetary policy has been eased in a number of countries over the past year, partly in response to currency appreciations, but room for further monetary expansion seems to be limited as inflationary pressures are building. As most economies in the region have large budget deficits, fiscal policies will continue to focus on consolidation. The region's downside risks include the possibility of weakening business confidence in EU which may, however, be mitigated if it causes some EU firms to relocate some production to the region as a cost-cutting measure. A major policy challenge for each of these economies is to work out a comprehensive post-enlargement strategy that minimizes any adverse impact from the application of EU rules and regulations, entailing, for example, the need to phase out production subsidies and abolish preferential tax treatment for foreign investors.

Growth in the *Baltic States* will remain robust in 2004-2005, reflecting success in broad-based structural policies and gains in macroeconomic stability. Rapid wage growth and expansion of consumer credit have contributed to strong growth in private consumption, and gross fixed capital formation is also booming. EU membership should be beneficial for these economies in the long run, but uncertainties associated with entry into EU may pose some short-term risks.

The broadening of the recovery in 2003 is reflected in an increase in the number of countries that achieved per capita output growth of more that 3 per cent and a slight decrease in those experiencing a fall in per capita output (see table I.2).

Table I.2
Frequency of high and low growth of per capita output, 2001-2003

	Number of countries monitored	*Decline in GDP per capita*			*Growth of GDP per capita exceeding 3 per cent*		
		2001	*2002*	*2003[a]*	*2001*	*2002*	*2003[a]*
		Number of countries					
World	146	40	37	34	43	41	52
of which							
Developed economies	24	2	4	8	2	3	2
Economies in transition	27	1	1	0	22	22	22
Developing countries	95	37	32	26	19	16	28
of which							
Africa	38	11	10	11	10	6	12
Eastern and Southern Asia	18	7	3	3	4	6	7
Western Asia	15	7	7	5	4	3	6
Latin America	24	12	12	7	1	1	3
Memorandum items							
Least developed countries	41	12	14	14	12	7	11
Sub-Saharan Africa	31	10	9	11	8	6	9
	Share[b]	*Percentage of world population*					
Developed economies	14.3	4.7	2.4	3.0	0.2	0.3	0.2
Economies in transition	6.9	0.0	0.1	0.0	5.6	5.4	5.9
Developing countries	78.8	10.4	8.1	10.6	45.2	29.2	50.2
of which							
Africa	12.8	2.6	2.0	3.0	3.4	1.4	3.0
Eastern and Southern Asia	53.4	1.3	1.3	1.0	40.4	25.0	43.7
Western Asia	4.0	2.4	1.3	1.2	1.2	2.3	2.7
Latin America	8.6	4.2	3.5	5.5	0.2	0.4	0.7
Memorandum items							
Least developed countries	10.8	2.1	2.9	3.5	3.7	1.5	4.2
Sub-Saharan Africa	7.8	2.5	1.9	3.0	2.7	1.4	1.8

Source: UN/DESA, including population estimates and projections from *World Population Prospects: The 2000 Revision*, vol. I, *Comprehensive Tables* and corrigendum (United Nations publication, Sales No. E.01.XIII.8 and Corr.1).

[a] Partly estimated.

[b] Percentage of world population for 2000.

The economies in transition fared even better than in 2002, with per capita output growing in every case and in the majority of countries by more than 3 per cent. Although the number of countries in Africa that increased per capita output by this amount grew in 2003, the majority of people in that region are living in countries where growth was below this long-term benchmark for meaningful poverty reduction. Almost one quarter of that region's population live in countries where per capita output fell in 2003. In Western Asia, while the overall situation improved, there was a sharper dichotomy between fuel-exporting countries and fuel-importing countries, with most of the former exceeding the 3 per cent benchmark and most of the latter recording falls in output per capita in 2003. In Eastern and Southern Asia, four fifths of the population lived in countries, notably China and India, that exceeded 3 per cent growth of per capita output in 2003; the proportion living in the three countries in the region where per capita output declined was very small. In Latin America, the number of countries experiencing a decline in per capita output fell in 2003 but the proportion of the region's population affected rose: almost two people of every three were in countries where output per capita declined.

The extended rapid economic growth of the two most populous economies in the world, China and India, is reshaping the global economy in various respects (see box I.1 for the case of China). Over recent decades, both countries have gradually, but actively, integrated themselves into the world economy through a judicious mix of State intervention and gradual market-oriented reforms and other changes, but there have also been marked differences in their economic structures and in their paths towards high growth. China's growth has mainly featured rapid expansion in manufacturing with intensive inputs of raw materials and labour, whereas India's rise has manifested itself chiefly in the service sector, especially in IT-related activities and back-office services. China has become a major importer of raw materials and oil; Indian demand for oil is also rising, but to a lesser extent. China is in direct competition with other developing economies in its exports to third markets, while India's success in IT and business outsourcing means that it is increasingly competing with skilled labour in developed economies. China's economic ties to neighbouring countries are stronger and therefore potentially more beneficial to the region than are those of India, whose main trading partners are the developed countries. However, there is potential for stronger regional economic integration in South Asia and between South and East Asia in the future.

Box I.1

Global implications of the rising economic weight of China

The economic weight in the world economy of China, with its growth of over 9 per cent annually for more than two decades, has been rising.[a] Although its external economic ties, if measured by trade flows, are concentrated in Asia, China's international economic linkages are more diversified if other factors are taken into account (see table).[b] With its external sector expanding more vigorously than that of the rest of the world by a wide margin,[c] China is integrating into the global economy rapidly and ubiquitously.

Like the take-off in Japan and a few Asian newly industrialized economies in earlier years, the steady growth and openness of China should be beneficial not only for the country itself, but also for the world

as a whole: it is increasing global economic welfare and generating positive synergies for other economies. The same experience also suggests, however, that China's rapid integration into the world economy is likely to lead to intensified international competition in various sectors and significant relocations of resources across sectors and countries.[d] At the same time, a number of characteristics relating to China's size, structure and institutions are likely to make its global impact greater than that of the historical cases of Japan and the newly industrialized economies.[e]

Size matters. China's population, accounting for 21 per cent of the world total, is a multiple of that of Japan and the newly industrialized economies combined whereas, despite its rapid growth, China's share of GWP is only about 3.5 per cent. Historically, China was a major economic power for the first 18 centuries AD, accounting for 20 per cent or more of the world economy. The recent revival might be the beginning of China's return to its long-term average position. If this is the case, China's size alone will have wide-ranging implications in terms of global aggregate demand, supply and the international balance of goods, services and financial resources.

China's trade with the rest of the world, 2003 (Percentage)

Region	*Share of China's total trade*	*China's share of region's trade*	*Region's share of world gross product*
Africa	2.2	6.1	1.8
Southern and Eastern Asia (including Japan)	54.7	18.0	22.9
Western Asia	3.7	6.5	2.7
Europe	18.5	2.8	30.2
Latin America	3.2	3.6	6.2
North America	15.8	5.3	34.6
Oceania	1.9	9.5	1.5

Source: UN/DESA, based on national and international data.

The impact of its size has already manifested itself. For example, China's demand for raw materials and energy has recently accelerated exponentially, driven by soaring consumption demand for housing and cars and by booming investment.[f] This, along with other factors, has caused the international prices of many commodities to surge to multi-year highs. Although China is still at an early stage of industrialization, it already accounts for 25 per cent of the world consumption of iron and steel, 30 per cent of world consumption of coal and 20 per cent of world consumption of cement. Furthermore, these proportions are expected to grow. China's strong demand for raw materials and energy is beneficial for many commodity-exporting countries, but the consequentially higher commodity prices are unfavourable for a number of other economies. A more profound question, however, is whether the supply of global raw materials can accommodate such rapidly growing demand from such a large economy or whether China's growth will be curbed by limited global resources.

The structural implications for the world economy are more complex, varying by countries and sectors. A prodigious low-skilled labour force, low labour costs,[g] a scarcity of arable land per capita, and high household saving rates are among the major structural features of the Chinese economy that give rise to its comparative advantage in producing labour-intensive goods in the world economy. Most developed economies will benefit from the import of low-cost manufactured goods made in China and from the export of capital- and technology-intensive products to China. Developing countries that produce raw materials and land-intensive products will benefit from the complementarity of their structure with that of China, but others, particularly those with a similarly labour-intensive structure, will face heightened competition and will be under increasing pressure for structural adjustments. Some of these adjustments, including the relocation of labour, may be costly and difficult in the short run. Meanwhile, even though China receives a large proportion of foreign direct investment (FDI) inflows, its high domestic saving rate suggests that China's dependency on external financing will be lower than that of most other developing countries, so that China will not be a major competitor for global capital.

The institutional implications are also important, both for the rest of the world and for China itself. Notwithstanding the progress over the past two decades in transforming a centrally planned economy into a market-based one, China's institutional economic framework remains different from that of other economies in such respects as its large proportion of State ownership, the direct involvement of the government in economic decision-making[h] and its underdeveloped legal, banking and financial systems. These institutional factors may lead to international frictions during China's integration into the global economy, as already reflected in various disputes on trade and intellectual property rights and the recent discussions about China's exchange-rate policy, for instance.

Facing these institutional challenges, China may have to accelerate its reforms, as occurred with its recent accession to the World Trade Organization, which, among other effects, narrowed some institutional gaps between China and the rest of the world. On the other hand, the rest of the world should be patient about the pace at which China carries out its reforms as well as wary of the potential risks associated with any possible slippages or pitfalls in these reforms. For example, a combination of the fragile financial system, the heavy direct government involvement in economic activity, and the excess investment in some sectors, if aggravated by a misstep in reforming the exchange-rate regime or the capital account, could lead to a financial crisis in China, undermining not only its growth but also that of the world economy.

The sustainability of China's growth will also be challenged by various economic as well as institutional constraints, but a stronger and growing Chinese economy should be beneficial for the global economy as a whole; conversely, a stagnant and unstable Chinese economy would be disadvantageous for the rest of the world. China's emergence also implies, however, significant challenges for many other economies, often necessitating structural adjustments. Such adjustments can be costly, but they can also be smoothed by increased international economic

cooperation, such as China has been increasingly engaging in with the Association of South-East Asian Nations (ASEAN) and Africa. A continuation and strengthening of such cooperation will be important in ensuring that the world economy is not adversely affected by either the challenges of an ever-larger China in the world economy or the growing negative global repercussions should the economy of China falter.

[a] China's contribution to global economic growth was about 15 per cent in 2002-2003.

[b] For example, China's trade with Africa is only 2.2 per cent of China's total trade, but this share is in line with Africa's 1.8 per cent share of world output. China's economic relations with the rest of the world would appear even more diversified if the distance factor was taken into account, as in "gravity" trade models.

[c] In 2003, China's share of world trade reached 7 per cent, surpassing Japan's. China thus became the third largest trading nation and was the world's largest recipient of FDI.

[d] For example, Japan's economic emergence in the post-war period was accompanied for decades by escalating trade disputes and fears on the part of many other economies.

[e] Quantitative studies of this issue can be found in, for example, Yang Yongzheng, *China's Integration into the World Economy: Implications for Developing Countries*, IMF Working Paper (WP/03/245) (December 2003); Ma Jun, "China: changing the landscape of the world economy", *Deutsche Bank China Economics*, February 2003; and Global Insight, "China's impact on the world recovery", *Global Executive Summary*, February 2004.

[f] The ratio of electricity demand to GDP reached 1.7 in 2003; for iron and steel, above 2; for non-ferrous metals, above 2; and for cement, near 2. The world average for these ratios is normally below unity.

[g] China's wage ate in manufacturing is about 5 per cent of that in major developed economies and less than one third of that in Mexico.

[h] China has undergone extensive decentralization, but the direct involvement of the provincial and local governments in economic activity remains intense, and may have become even more intense than before, replacing the reduced role of the central government.

Revitalizing employment

With only a few exceptions, most economies are facing pressures from weak employment growth. There are two different employment problems. The first is a cyclical one, referring to the inability of the labour market to reverse the lay-offs during the earlier economic downturn and to absorb, at the same time, the natural increment in the labour force. As a result, unemployment rates remain much higher than normal. The second is a structural employment problem, namely, the persistently high unemployment and underemployment prevailing in many developing (and some developed) countries that are not attributable to the business cycle. Many economies are facing both problems, although the focus of policy concerns varies from country to country.

Among the developed economies, policy concerns in the United States are mostly focused on the slower-than-expected cyclical recovery in the labour market: the unemployment rate rose from 4 per cent in 2000 to a peak of above 6 per cent in 2003, dropping only to 5.6 per cent in mid-2004.[3] In Japan, the decade-long stagnation pushed up the unemployment rate from 3 per cent in the early 1990s to about 5 per cent. This is low compared with the unemployment rate of most developed countries but Japanese unemployment is more structural in nature (although there has been some tentative improvement with the recovery of the economy). Most Western European economies are challenged by both structural and cyclical employment problems. Unemployment rates remain the highest in a few large European economies, but current levels are still measurably lower than the peaks of the mid-1990s: the mild rise in unemployment rates in recent years because of weak economic growth seems not to have reversed the downward trend achieved by various reforms of labour markets over the past decade, but lowering unemployment further will require a continuation of the reforms.

The contrast between robust GDP growth and persistent weakness in the labour market in the United States has triggered a broad debate. Some observers have ascribed the hesitant recovery in the labour market to strong productivity growth, as businesses have continued to benefit from the rapid innovations in ICT over the past decade, allowing them to raise output without much increase in labour input. Other analysts blame the weak employment growth on increased global economic integration, arguing that the increase in imports from developing countries has led to reduced job creation in manufacturing in the United States, while outsourcing has reduced domestic job opportunities in the services sector.

These explanations may be partially true at the firm or industry levels, but do not hold at the macroeconomic level where efficiency gains from either technological change or international economic integration should not harm aggregate employment as long as effective demand grows in tandem with potential output growth. Thus, the delayed recovery in economy-wide employment in the United States is not a result of the efficiency gains per se, but the consequence of a lag, or failure, in translating these gains into a sufficient effective demand.

Unemployment in developing countries and economies in transition is even more severe, in both cyclical and structural terms. So far, only a small number of countries in Asia and in the group of economies in transition have registered a cyclical recovery in unemployment rates. Even so, the unemployment rates for most Asian economies are still far above their levels prior to the Asian financial crisis of the 1990s; and, despite some improvement, unemployment rates in the economies of transition are still high. The unemployment problem in a number of East Asian economies, where the degree of industrialization has already reached certain high levels, has been mainly cyclical; but in China and many other Asian economies, where rural areas still account for a large share of the population, the presence of large amounts of surplus labour, or repressed unemployment, in rural areas remains a long-term policy concern.

The most difficult structural unemployment and underemployment problems, however, are found in Africa and some Latin American economies. In South Africa, for example, the official unemployment rate stands at 28 per cent — a figure that, as in most developing countries, does not include those who are not officially recognized as unemployed. High unemployment and slow economic growth in these

economies are creating a vicious circle within which a large proportion of the population are entrapped in perennial poverty. The structural unemployment problems in some of these economies have also been aggravated by cyclical factors and the effects of downsizing the public sector and fiscal consolidation. In addition to the unemployment resulting from the latter, there are persisting high levels of underemployment in the public sector in many countries.

The solution to the problem of high unemployment in these countries will depend on lifting their economies to a sustained path of industrialization and on continued investment in human capital to improve the quality of labour. However, a number of external measures, such as further improvements in market access in developed countries for the exports of these countries, particularly labour-intensive products, could alleviate the situation. A number of African countries that were able to use the trade preferences granted by some developed countries in the past few years have already seen salutary effects on employment, although these are generally small in relation to the overall level of employment.

The baseline forecast predicts a progressive and cyclical improvement in the employment situation in 2004-2005 as the global economic recovery solidifies further. On the other hand, the longer the delay in the recovery of employment in the developed countries, the higher the risk of a relapse in the global recovery because consumer confidence will weaken and household spending will falter. As part of the effort to avoid this situation, government policies should include mechanisms to support labour relocation, including providing training and assistance to workers who are in transition as a result of technological change or global economic integration. Although it is among the approaches sometimes proposed, international protectionism will not lead to an efficient solution of unemployment problems.

Restraining inflation

As global growth solidifies and excess capacity declines, the policy focus has gradually shifted from worries about global deflation towards concerns about the risks of a rise in global inflation.

Inflation concerns have been kindled mainly by a substantial rise in many commodity prices. The prices of petroleum, metals, fats and oils surged, rising 50 per cent or more in a year to reach their highest levels for several years, although some prices, notably of tropical beverages, weakened in the first quarter of 2004. Rising global demand is a common factor behind the recovery of these prices, particularly the strong growth in China's demand for raw materials and energy (see figure I.1). The substantial depreciation of the United States dollar vis-à-vis other major currencies may also have contributed to the higher prices of commodities: historically, these prices, since they are mostly quoted in United States dollars, tend to move inversely with the exchange rate of the dollar. At the same time, supply constraints, such as the poor soybean harvest and labour disturbances at some mineral sites, have also pushed up the prices of specific commodities.

Petroleum prices have remained persistently high for the past year, surging to their highest level in a decade. Despite the fact that the price of petroleum has been significantly above the target range of $22-$28 per barrel (pb) that it has established, the Organization of Petroleum Exporting Countries (OPEC) has continued to announce production cuts, partly in an attempt to adjust the target so as to take

account of the depreciation of the United States dollar. At the same time, global demand for oil has been on the rise owing to accelerating world economic growth. In addition, geopolitical concerns have increased the pressure placed on many countries to build or replenish strategic petroleum reserves, adding further to global oil demand.

The pass-through of higher commodity prices to overall inflation has so far been minimal, suggesting that a large proportion of the rise in the prices of commodities was absorbed by producers and distributors, instead of being passed on as higher prices to consumers. Headline inflation has edged up in a large number of countries, but "core" inflation measures — excluding such volatile components as food and energy prices — remain relatively stable. Economies that previously had rapidly increasing price levels, such as a few Latin American countries and economies in transition, have reduced inflation further. In some other economies, deflationary pressures have been dissipating; in China, mild deflation for the past few years has been replaced by moderate inflation.

In addition to higher commodity prices, other potential inflationary factors include: the depreciation of the United States dollar, in which a large part of international trade is invoiced; the unsterilized foreign exchange interventions by central banks in a number of economies in response to the depreciation of the dollar; the relatively high and growing fiscal deficits in many countries; and overheating in some economies and exuberance in some sectors, as exemplified by higher housing prices in a number of countries and the torrid pace of fixed investment and credit expansion in China.

On the other hand, there are several forces restraining inflation, as reflected in the persistence of low rates of inflation to date. The monetary policy of many central banks is focused on controlling inflation, with the policy rules in a number of cases inherently engineered to be more aggressive in fighting inflation than in handling deflation. Macroeconomic management in many developing countries has improved. Global integration has increased international competition and thus curbed monopoly power.[4] Technological innovations have raised productivity growth. Various economic reforms, both in domestic markets and in international trade and financial systems, have reduced rigidities and barriers. As long as these factors persist and firmly anchor low inflationary expectations, global inflation should remain under control.

Given this generally benign inflation environment, global monetary policy has remained accommodative, with only a few exceptions. While it appears that the three-year cycle of global monetary easing is about to end, a number of central banks have indicated that they will show restraint in raising interest rates. The baseline forecast assumes a gradual increase in policy interest rates by major central banks in late 2004, but a number of economies that are behind in the recovery cycle could maintain low interest rates for a longer period. The difficulty lies in judging the uncertain lag between the activation of monetary policy and its effects on the economy: this will require finesse by central banks, in addition to a sound policy framework. Gradualism and transparency of the policy intention will be crucial in avoiding an abrupt reaction in financial markets, which may otherwise push up long-term interest rates to levels that might dampen investment.

The difficulties for fiscal policy in many economies are even greater. Current fiscal policy stances vary substantially from country to country. Among the

developed countries, fiscal policy remains the most expansionary in the United States, modestly stimulatory to neutral in most Western European economies and restrictive in Japan. Fiscal policy has been stimulatory in most Asian developing economies, mainly restrictive in Latin America, and mixed in other developing regions and in economies in transition. However, one common trend throughout the world is the widening of government deficits, accompanied by rising public debt. The exceptions are few, one being the Russian Federation, with its large budget surplus from increased oil revenues. Several Latin American economies have also made notable progress in achieving a surplus in their primary balances as a result of more disciplined fiscal policy in recent years. Most economies are expected to have to undertake fiscal consolidation in the next few years. Although only a few have started this process so far, fiscal policy in general will become less stimulatory around the world in 2004-2005.

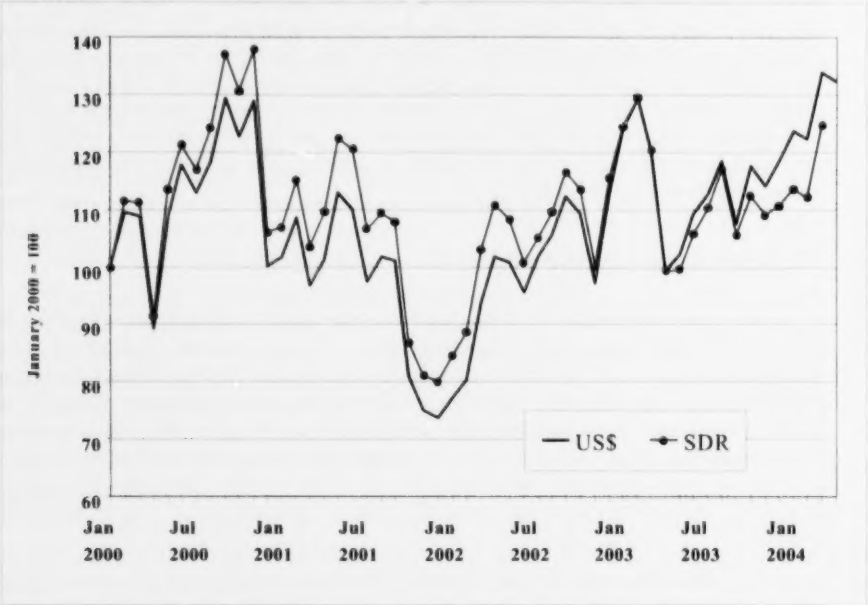
Managing downside risks

The improved short-term prospects for the world economy are tempered by some potentially far-reaching downside risks. As the second quarter of 2004 unfolded, the spectre of international terrorism, geopolitical concerns and increased political instability was once again hovering over the world economy. None of the events triggering this development were global in scale but the increased interdependencies across countries and between the political and economic domains resulted in the translation of a number of those events into enhanced global economic uncertainty, with the possibility of a dampening of future economic growth.

This possible outcome was reflected first and foremost in the price of oil, which rose rapidly after early April 2004 to above $40 pb, its highest level in about two decades. From a positive perspective, oil prices are still 30 per cent lower than the peak of the 1980s if measured in constant United States dollars. Furthermore, a large part of the increase in the oil prices has reflected the substantial depreciation of the dollar vis-à-vis other major currencies. If measured in special drawing rights (SDRs), oil prices are not much higher than in 2000 (see figure I.1).

Figure I.1
Price of Brent oil in United States dollars and special drawing rights (SDRs), first quarter 2000 — first quarter 2004

(Index: first quarter 2000 = 100)



Increases in oil prices redistribute income from oil consumers to oil producers and from a large number of oil-importing economies to a relatively small number of oil-exporting countries. Recent quantitative studies suggest that an increase of $10 pb in petroleum prices will lead to a loss of about 0.5 per cent in GWP.[5] If the shock is severe, the slowdown is likely to be aggravated by a series of indirect, but even more severe, shocks brought about by a sharp collapse of consumer and business confidence because of the higher prices. The two previous major oil shocks (1973-1974 and 1979-1980) suggest that the negative indirect consequences are likely to be larger than the direct effects. During these previous shocks (when oil consumption per unit of GDP was far higher that at present), the index of consumer confidence in the United States dropped by more than 50 per cent when oil prices stayed at their peak levels for about 6-12 months. In both instances, this loss of confidence resulted in a recession in the United States, to the detriment of growth in the world economy as a whole.[6] On this occasion, there has been no major disruption in the supply of oil. Nevertheless, the previous experiences suggest that, if the higher prices increase further or even persist for some time, global economic growth is likely to be curbed.

The impact of an oil price shock varies across country groups. The direct income effects of increased oil prices for net fuel-importing countries depends on the share of oil in total consumption. Most developed economies, the United States

in particular, are still the largest per capita consumers of oil, but changes in the structure of output towards services, increased energy efficiency and greater use of non-oil sources of energy have made output in most developed economies less oil-intensive, reducing the direct adverse impact of any "oil shock". Meanwhile, industrialization in many developing countries during the past decade has been oil-intensive; in particular, oil consumption in Asian developing economies has increased significantly, making them more vulnerable than previously to increases in prices and, in several cases, more likely to be affected than other countries in relative terms. For instance, oil consumption per unit of GDP in China and many other developing countries is more than twice that of most developed economies. As a result, for any given oil price shock, these countries will experience a larger adverse effect than during earlier episodes. In addition, higher oil prices might trigger financial instability, for example, a currency crisis, in some fuel-importing developing countries that already have sizeable external deficits.

Some analysts have drawn a parallel between the current situation and the oil shock in the early 1970s and the subsequent collapse of the world economy. A significant difference between the two situations is that the oil crisis of the 1970s was a pure supply-side shock, involving a disruption of oil supply by the major oil-producing countries; the current rise in prices has been driven mainly by higher demand. So far, there has been no large-scale disruption of supply; to the contrary, the major oil-producing countries have indicated a willingness to accommodate the increases in demand.

A second major downside risk for the world economy is the series of large and widening global imbalances. The most threatening of these are the twin deficits of the United States, but there are also deteriorating fiscal positions in many other economies and high private debt levels in some, in certain cases accompanied by substantially appreciated housing prices. Some of these risks will be heightened when global interest rates rise, particularly if they rise abruptly as a result of either inappropriate monetary policy or panics in financial markets.

The deteriorating fiscal position of the United States poses particular global risks. The country's budget balance shifted from a surplus of above 2 per cent of GDP in 2000 to a deficit of about 4 per cent of GDP in 2003. Even the most optimistic projections show that large fiscal deficits are likely to persist for a considerable period of time unless there is a major change in policy.

By spurring domestic growth, the United States fiscal stimuli played an important role in making the United States the "locomotive" for the global economic recovery. More recently, concerns have risen regarding the sustainability of this fiscal deficit and the fact that it might lead to higher long-term interest rates in global capital markets and to a consequential dampening of global investment and growth in the longer run. Moreover, the inextricable linkages among the fiscal deficit, the external deficit and the exchange rates of the dollar vis-à-vis other currencies mean that the fiscal deficit has broader direct risks for the stability of the world economy.

In this sense, the notion of the United States as a locomotive for the world economy becomes more complex. This locomotive has been powered by resources borrowed from the rest of the world: the current-account deficit of the United States, a measure of how much of the spending by the United States is financed by borrowing from abroad, is more than 5 per cent of GDP. The sustainability of the

United States economic expansion is therefore crucially dependent on the willingness of the rest of the world to continue to lend to the United States by accumulating United States assets, mostly United States Treasury bonds.[7] Such a pattern of interdependency between the United States and the rest of the world is unlikely to prove sustainable.

The emergence of new engines of growth for the world economy, such as China and India, has added resilience to, but has also raised additional risks for, the world economy and for many individual countries. These risks are associated with overheating in some sectors and a weak financial sector in China, and with the large fiscal deficit in India. Imports by these two countries have become an important component of demand in some global markets, notably commodities, and for some regions and countries (see figure I.1). The possibility that the rapid pace of growth in China, particularly in some specific sectors, will not be maintained, would result in a loss of vibrancy in China's import demand. A sudden retrenchment, especially if it permeated the whole Chinese economy, would have far-reaching negative consequences elsewhere, most notably for those countries that have benefited from the China-driven commodity boom. India's lower degree of integration into the world economy means that its performance is of somewhat lesser global concern, particularly to developing countries.

Developing countries and economies in transition remain highly vulnerable to these uncertainties and risks. The anticipated increases in interest rates can have only a negative impact on developing countries that are active in international capital markets, since the overwhelming majority of these countries are net borrowers. Continued volatility in the exchange rates among the major currencies will have different net effects on individual developing countries and economies in transition, with some receiving a net benefit and others a net loss, depending on the extent to which their trade flows, external debt and international reserves are dollar-based. However, most of these countries are less well equipped than developed countries to manage volatility in exchange rates and some are likely to suffer a negative short-term shock.

Developing countries have very little influence on these developments in the international economy and yet they are subject to them. That it is the responsibility of the developed economies, particularly the largest among them, to take measures to ensure an orderly unwinding of the global imbalances, suggests that multilateral surveillance for the time being should focus primarily on the policies of these economies. It is particularly important to ensure that the correction of the imbalances does not disrupt the development efforts of the poorest countries. It will therefore be necessary to ensure not only a consistent approach across countries but also coherence between policies and measures intended to restore macroeconomic balance in the world economy and those intended to foster long-term growth and development in the developing countries. Particular efforts should be made to ensure that the adjustment is achieved by raising growth in those countries that are lagging, rather than by reducing global demand. Above all, there should be no relaxation in the commitments to advance development made by the developed countries in the United Nations Millennium Declaration,[8] the Monterrey Consensus of the International Conference on Financing for Development,[9] the Doha development agenda and the Plan of Implementation of the World Summit on Sustainable Development "Johannesburg Programme of Implementation".[10]

Delivering on the commitment to development

In addition to managing the short-term economic risks, global leaders need to restore the priority given to international cooperation for development. Renewed efforts are urgently required to fulfil the various commitments that were made in the first few years of the new century to improve the human well-being of the overwhelming majority of the world's population who live in developing countries.

Few developing countries — and almost none of the poorest — seem likely to achieve all of the Millennium Development Goals unless there is accelerated progress on the key domestic and international actions that have already been universally agreed. Encouragingly, however, China and India, homes to most of the world's poor people, seem likely to achieve the poverty reduction goal, largely because of their high rates of economic growth. The challenge is to ensure that other countries are able to emulate these examples.

From a long-term, as well as a short-term, perspective, the priority must be to sustain the global cyclical recovery, to transform it into robust long-run growth, and to transform such growth into poverty reduction and the fulfilment of other Millennium Development Goals. Most of the countries that face the greatest challenge in achieving the Millennium Development Goals — largely the least developed countries and most countries in sub-Saharan Africa — are mired in a "poverty trap".[11] A substantial acceleration in economic growth is indispensable in most of these countries if they are to achieve the primary goal of reducing poverty by half by 2015. Not only would achieving a quantum improvement in their rates of economic growth have a direct effect on incomes and poverty but it should also transform their present vicious circle of underdevelopment into a virtuous circle that sustained growth over the longer term: higher growth itself generates additional resources that will relieve the present downward pressures on these countries and contribute to further growth.

Particularly for smaller developing economies, improving the international trading environment could provide important opportunities for accelerating growth, as recognized in the collective decision to launch a series of trade negotiations that would be development-oriented. Since that decision taken in Doha in November 2001, there has been very little progress in translating the universal good intentions into tangible results. In view of the continuing difficulties in achieving concrete progress in the key areas, negotiators need to look beyond the particulars of the individual subject areas and identify ways and means, possibly far from the approach originally envisaged, of achieving the overriding objective of ensuring that the international trading system is more conducive to the development of developing countries. Although all parties recognize the sizeable benefits that should result from successful trade negotiations and their centrality to development, these benefits are being reduced through the resort to second-best bilateral solutions because of failure at the global level. In trade negotiations possibly more than elsewhere, time is of the essence if growth in the poorest developing countries is to be raised to the level necessary to achieve the poverty objective set out in the United Nations Millennium Declaration. The aim must be to ensure that developing countries are provided with improved market access for products and services in which they have export potential.

Introduced by IMF as a new arrangement for "Support for Trade-related Balance of Payments Adjustments", the so-called Trade Integration Mechanism (TIM) is an important innovation intended to assist developing countries in meeting any short-term costs of trade liberalization; but it only is a small step in relation to the overall need to ensure that trade can contribute more extensively to growth and the reduction of poverty in developing countries. Developing countries need assistance in expanding their supply capacity for those goods and services in which they have export potential and they need to develop capacities to export before they can reduce their levels of protection. There is growing evidence that reduced levels of protection do not lead automatically to the development of export capacities and the strong links between export sectors and domestic economic activities that result in rapid economic growth.

Attainment of many of the other Millennium Development Goals can be achieved largely through social policy and, above all, by interventions by the Government to provide additional institutional, physical, human and financial resources. A major constraint on achieving these goals is the overall lack of public resources. Governments of developing countries therefore need to continue their efforts to improve efficiency in the use of public resources through strengthened governance and public administration. In addition, they have to raise additional financial resources domestically through more efficient and effective systems of taxation and through improved financial intermediation to mobilize domestic savings. At the same time, success in raising the rate of economic growth should yield additional resources for development purposes, including within the private sector.

Particularly in the poorest countries, however, increasing the mobilization and effective use of domestic resources is unlikely to be sufficient to meet the Millennium Development Goals. For this purpose, developing countries will need additional international support. A first avenue for such support is debt relief because it immediately releases for domestic use financial resources that otherwise might be paid to foreign creditors. Completion of the Heavily Indebted Poor Countries (HIPC) Initiative is therefore of crucial importance to reviving growth in the poorest countries; every effort should be made to ensure that all eligible countries reach their completion point before the Initiative is terminated. At the same time, it is fully recognized that the debt relief provided under the Initiative has been insufficient to achieve its goal of ensuring debt sustainability in all beneficiary countries because the measure of sustainability was based on assumptions regarding economic growth, export growth and interest rates that proved to be optimistic. Development partners should ensure that, in all such cases, countries reaching the completion point are provided with the additional relief needed to ensure debt sustainability.

Debt sustainability is a multifaceted concept that, like most other aspects of development, has to be considered in the light of the circumstances of each individual country. Ongoing work in IMF and the World Bank to refine the concept of debt sustainability from this point of view is therefore welcomed. Similarly, the Paris Club's adoption of a more flexible approach to countries in debt difficulties is to be commended. The ongoing consideration of ways of introducing greater variability and flexibility into debt instruments, such as linking debt-service payments to changes in capacity-to-pay (for example, through bonds indexed to GDP or commodity prices), should also be pursued. Nevertheless, the lack of

multilateral frameworks for resolution of debt crises continues to be responsible for one of the great vacuums in the international financial architecture.

Particularly in the poorest countries, debt relief and debt sustainability will not obviate the need for additional concessional resources for development. Flows of ODA have increased for the past few years and, on the basis of commitments already made, further increases are expected over the short term. Recent increases, however, have in part been a reflection of the depreciation of the dollar, the inclusion of debt relief and expenditures in Afghanistan and Iraq. Looking ahead, the increases in ODA that are currently foreseen, while highly commendable in themselves, are modest in relation to the volumes that are widely estimated to be required to achieve the Millennium Development Goals. Encouragingly, there are a number of proposals on how to improve the situation, including the financing of the fourteenth replenishment of the International Development Association (IDA) and the proposed international financing facility (IFF).

Over the longer term, many developed countries already face fiscal constraints. Additional demands, particularly those associated with the ageing of their populations, are likely to increase this fiscal pressure as time progresses, and to compromise ODA flows. This suggests that attainment of the Millennium Development Goals will require a strategy for identifying potential new sources of financing over the longer term. It is therefore encouraging that the Development Committee (Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries), at its meeting in April 2004, took a first step in this direction when it called for a report for its next session addressing "policy options and financing mechanisms for mobilizing additional resources (including examining an international finance facility, global taxation and other proposals)".[12] Hopefully, this will mark the first step towards formulating a strategy that will ensure the necessary flow of resources not only until 2015 but beyond that date so that poverty can be not only halved but eradicated.

The collective policy challenge is, on the one hand, daunting but, on the other hand, achievable, as reflected in the progress already made. There is universal recognition that development policy in developing countries, in all its many facets, has improved over recent years. Similar strides have been made by donor countries, not least in the recognition that country-ownership is a sine qua non for successful development policies. Despite the supposed onset of "aid fatigue", flows of ODA increased in 2002 and 2003, with commitments of further increases in the pipeline. There has been some, albeit inadequate, progress made in reducing the debt burden on developing countries, most particularly the HIPCs, and some improvements in the treatment of external debt of the middle-income countries as well.

These steps indicate that the necessary actions are universally recognized and are feasible, provided that there is the necessary political will. The challenge to the Governments of both developing and developed countries is to undertake such actions not only on the scale that is necessary to achieve the Millennium Development Goals but also within a time frame that ensures that the Goals are met by the target date of 2015. Anything less would be a betrayal of the faith that peoples deserve to have in their Governments and in international organizations.

Notes

[1] See *World Economic Situation and Prospects, 2004* (United Nations publication, Sales No. E.04.II.C.2). Also available from www.un.org/esa/policy/index.html (accessed 14 June 2004).

[2] See *World Economic Situation* ..., chap. III, for the presentation of a detailed regional economic outlook.

[3] Strong growth in payroll employment was finally registered in March 2004, but a continuation in coming months is necessary to confirm a steady recovery in the labour market of the United States. Although the unemployment rate in the United States fell from a peak of 6.3 per cent in mid-2003 to 5.6 per cent in March 2004, the improvement was due mainly to a drop in the labour-force participation rate, particularly for younger people; the unemployment rate would otherwise have been about 7 per cent.

[4] Increased exports from China, for example, have prevented international prices of manufactured goods from rising. At the same time, China's strong growth has contributed to higher commodity prices and given China a dual role in influencing global inflation.

[5] See, for example, International Energy Agency, "Analysis of the impact high oil prices on the global economy", May 2004, available from http://library.iea.org/dbtw-wpd/textbase/papers/2004/high_oil_prices.pdf (accessed 15 June 2004).

[6] Most quantitative studies involve static comparative analysis and capture only the linear relationship between oil prices and the welfare loss through income and substitution effects; hence they cannot reflect the non-linear impact from the shock on confidence. A DESA simulation suggests that, if there were the same decline in consumer sentiment today, growth in the United States would decline by more than 2.5 percentage points, verging on a recession. The ripple effects throughout the world economy would reduce the growth of GWP by 2 percentage points.

[7] Asian central banks are estimated to finance about half of the United States annual external imbalance by accumulating dollar-denominated reserves.

[8] See General Assembly resolution 55/2.

[9] *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex.

[10] *Report of the World Summit on Sustainable Development, Johannesburg, South Africa, 26 August-4 September 2002* (United Nations publication, Sales No. E.03.II.A.1 and corrigendum), chap. I, resolution 2, annex.

[11] For a discussion of the "poverty trap", see *World Economic and Social Survey, 2000* (United Nations publication, Sales No. E.00.II.C.1), part two.

[12] See Development Committee communiqué on "Concerted action needed to accelerate progress towards Millennium Development Goals", *IMF Survey*, vol. 33, No. 8 (3 May 2004), pp. 122-123, seventh paragraph.